No. 22,106

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CASA DORINDA ESTATES, also known as SANTA MARIA ACRES APARTMENTS, a copartnership, *et al.*, Debtor,

Appellant,

vs.

ALL-YEAR WEATHER, INC.,

Appellee.

On Appeal From the United States District Court for the Central District of California.

APPELLEE'S BRIEF.

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Appellant,

vs.

ALL-YEAR WEATHER, INC.,

Appellee.

On Appeal From the United States District Court for the Central District of California.

APPELLEE'S BRIEF.

Statement of the Case.

This is an appeal from the District Court's Order [C. T. 56], reversing the Referee's award of an 11 U.S.C. § 714 injunction, which restrained enforcement of trust deed liens [C. T. 25], and remanded the Chapter XI proceedings to the Referee to allow Appellee to pay the Debtor's unsecured debts and expenses of administration so that the proceedings could be dismissed as moot [C. T. p. 57, lines 16-26].

Appellee made a loan to Charles B. Herter and Evelyn F. Herter, the record owners of fifty (50) acres of land in Montecito, California [Ex. 6], upon the Herters' representation of ownership [Ex. 4, ¶ 1a]. The loan was evidenced by Herters' Promissory Note for

$107,621.44, secured by a *third* trust deed upon the land [Exs. 3, 4, 5].

Upon default on the second trust deed [R. T. 12/27/66, p. 4], and a scheduled trustee's sale [R. T. 12/27/66, pp. 70-71], the Herters, Homer F. Barnes and Mary F. Barnes filed a Debtor's Petition and a Petition for a Restraining Order claiming that: they were partners, dba "Case Dorinda Estates;" the land belonged to the partnership; the land was worth $800,-000.00 more than the four trust deeds against it; and the partnership had $7,177.14 in unsecured debts it could not pay [C. T. 2], together with a Proposed Plan of Arrangement calling for restraint of lien enforcement over a six-year payoff of the $7,177.14 in unsecured debts. A Temporary Restraining Order and Order To Show Cause was issued [C. T. 10].

Appellee filed papers in opposition [C. T. 14], pointing out that: the alleged partners were individually solvent; that the land was not the partnership's, and was not necessary, in any event, to any arrangement; that substantial injury would result to Appellee lienor; and that the "Plan" was not fair [C. T. 15-16].

At the hearing, Appellee offered to pay all the unsecured debts forthwith, and tendered a cashier's check for $7,177.14 [R. T. 12/27/66, pp. 6-17; Ex. 9 I.D.]. The Referee ruled that he lacked jurisdiction to accept it [R. T. 12/27/66, p. 17]. Appellee then called Charles B. Herter, Jr., as an adverse witness and established that Security Title Insurance Company (not "Casa Dorinda Estates") was the record owner of the land [R. T. 12/27/66, pp. 22-23; Ex. 1]; but was precluded from showing that "Casa Dorinda Estates"

had not filed a fictitious name certificate [R. T. 12/27/66, pp. 24-25].

Herter admitted that he had assets of his own* not included in the Debtor's Petition [R. T. 12/27/66, p. 27, lines 8-11]. The objection that further inquiry into the individual partners' assets was immaterial was sustained [R. T. 12/27/66, pp. 27-28]. Appellee offered to prove that the individual partners were solvent [R. T. 12/27/66, p. 28, lines 13-19]. The Referee held such offer to be immaterial [R. T. 12/27/66, p. 28, lines 20-21].

Herter testified that in his opinion the land was worth $1,200,000 and the equity (after 4 trust deeds and unpaid taxes) was $700,000-$800,000 [R. T. 12/27/66, pp. 83-91].

No proof was offered as to the necessity of the land to carry out the 6 year plan to pay off the $7,177.14 in unsecured debts.

Finding that the partnership owned the land, in which it had a substantial equity, the Referee granted the injunction [C. T. 25] "until further order of the above-entitled Court, or the final decree in these Chapter XI proceedings" [C. T. 31]. He did *not* find that the land was needed for the success of the Chapter XI proceedings, or as to either of Appellee's offers (payment of unsecured debts; individual partners' solvency). Nor did he find that the injunction would not cause injury to Appellee.

The District Court found that the Referee had "abused his discretion" in awarding the injunction, and

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*Including an airplane which he used like an ordinary man uses an automobile [R. T. 12/27/66, p. 47, lines 13-21].

concluded that the Referee erred in excluding proof of the partners' individual solvency, and erred in refusing to accept Appellee's offered payment [C. T. 52-55]. Whereupon the Court made the order herein challenged [C. T. 56].

Questions Presented.

1. What are the criteria for the award or denial of an 11 *U.S.C.* § 714 injunction restraining secured creditors' enforcement of their liens?

2. What is the scope of the court of appeals' review of a district court's findings that a referee "abused his discretion" in awarding an 11 *U.S.C.* § 714 injunction?

3. What is the scope of a district court's review of a referee's order awarding an 11 *U.S.C.* § 714 injunction; *i.e.* does the "clearly erroneous" rule apply to the referee's conclusion that an injunction is justified?

4. What is the effect of a district court's findings on issues material to the award of an 11 *U.S.C.* § 714 injunction the referee has failed to find upon?

5. May holders of secured liens against land who dealt with the record owner be enjoined pursuant to 11 *U.S.C.* §714 on the claim of such owner that the land was and is owned by a secret partnership which is now insolvent?

6. May a Chapter XI partnership whose partners are solvent be awarded on 11 *U.S.C.* §714 injunction?

7. Is a partnership entitled to a Chapter XI proceedings to "rehabilitate" itself where the partners are solvent?

8. Is a partnership whose individual members are solvent entitled to a Chapter XI proceedings to "rehabilitate" itself after a secured creditor offers to pay all unsecured debts and the reasonable expenses of administration?

Summary of Argument.

All injunctions call for the exercise of a delicate and sweeping power and should be awarded only in clear cases.

Injunctions awarded under 11 *U.S.C.* §714 must rest upon findings that the injunction is necessary for a fair and equitable plan to pay the unsecured creditors of an insolvent Debtor and will not cause substantial injury to the enjoined lienor.

Where, as here, a secured creditor offered to pay all unsecured creditors in full, forthwith, and the referee made no findings as to: (1) necessity of the injunction to safeguard the unsecured creditors; (2) fairness of the plan proposed; (3) solvency of the individual members of the Debtor partnership, the District Court was justified in making findings of its own on such material issues, reversing the Referee's award of an injunction and remanding the proceedings.

In such a case, the question is not whether the Referee's inadequate findings and conclusion that injunction should issue were "clearly erroneous"—the question is whether the District Court's findings are "clearly erroneous".

For "discretion" exercised on an imperfect grasp of the equitable and legal criteria for an 11 *U.S.C.* §714 injunction is not entitled to any weight whatsoever.

ARGUMENT.

A. The District Court Correctly Held, Under the Circumstances and the Law Governing 11 U.S.C. §714 Injunctions, That the Referee "Abused His Discretion" in Granting an Injunction.

1. Preliminary Statement.

11 *U.S.C.* §714 provides in relevant part:

> "The Court *may* . . . for cause shown, enjoin . . . any proceedings to enforce any lien upon the property of a debtor." (Italics ours).

Thus, in Chapter XI proceedings, the referee is granted the "power of imposing magnitude" (*Suhl v. Bumb,* 348 F. 2d 869, 871, 9 Cir.) of summarily restraining the normal enforcement of secured liens.

Such power is, however, to be sparingly exercised and then only when necessary to carry out the primary purpose of a Chapter XI proceeding—the payment of unsecured creditors.

> *In re Tracy,* 194 F. Supp. 294, N.D. Cal. 1961;
> *In re Brown,* 84 F. 2d 433.

As in all cases where an injunction is sought, an 11 *U.S.C.* §714 injunction should not be granted in doubtful cases.

> *Dyno Industries, Inc. v. Tapeprinter, Inc.,* 326 F. 2d 141, 143, 9 Cir., 1964.

As a general rule, appellate courts view the grant or denial of a prohibitory preliminary injunction as resting in the sound judicial discretion of the trial court, and limit determination on appeal to whether there has been "abuse of trial court discretion", "clear error,"

"violation of the rules of equity," or "improvident granting."

> *Maas v. United States,* 371 F. 2d 348, C.A.D.C. 1967 (and cases cited).

These considerations are particularly cogent when, as here, the injunction was not merely *pendente lite,* but "until further order of the above-entitled Court, or the final decree in these Chapter XI proceedings" [C. T. 31] (which, under the Debtor's Proposed Plan of Arrangement would be six (6) years from the approval of the Plan), and such "Plan" was not fair and equitable to unsecured creditors when compared with Appellee's offer to pay such debts in full, forthwith. (*Case v. Los Angeles Lumber Products Co.,* 308 U.S. 106, 114).

The Referee erroneously concluded that, in deciding whether an 11 *U.S.C.* § 714 injunction should issue, his inquiry should begin and end with the question of whether there was some equity in the property [R. T. 12/27/66, p. 30, line 18, to p. 31, line 1; R. T. 1/-5/67, p. 58, line 16, to p. 60, line 6]. Thus, his only finding relevant to the injunction was that there was a "substantial equity" [C. T. 28, lines 18-25].

The "adequate security" argument is also heavily relied upon by Appellant (Brief, pp. 21-23).

But the adequacy or inadequacy of the Appellee's security alone is "too narrow" a basis on which to grant or deny an 11 *U.S.C.* § 714 injunction.

As the Court pointed out in the case of *In re Empire Steel Company,* 228 F. Supp. 316, 319, D. Utah, 1964:

> ". . . If there is no possibility of submitting a plan except upon the happening of some future con-

tingency, the basis for any protracted stay simply does not exist. Otherwise, secured creditors could be indefinitely delayed, for almost every debtor hopes that something may happen in the future to relieve his plight and permit him to avoid foreclosure. Chapter XI would become simply authority for general moratoria against secured creditors rather than a means to permit appropriate submission, processing and consideration of plans of adjustment. The 'status' of secured creditors then unavoidably would be affected, for status depends not only upon assurance of eventual payment but the right to payment or enforcement in point of time bearing some relationship to the conditions of the security instruments."

* * * * *

"The Referee's consideration of the propriety of the stay was too narrow. The adequacy or inadequacy of the government's security was only one of the questions upon which a decision should have been predicated."

2. The "Clearly Erroneous" Rule.

It is, of course, plain that a referee's findings are subject to the "clearly erroneous" rule, and that a district judge should accept them unless there is no substantial evidence to support them, or unless the judge is left, after a review of the entire record, with the definite and firm conviction that the findings are wrong.

Rule 52(a), *F.R.C.P.;*

General Order No. 47 of *General Orders in Bankruptcy;*

United States v. United States Gypsum Co., 333 U.S. 364, 395.

Further, although there is some conflict among the circuits as to the scope of review in the court of appeals where the district court rejects the findings of the referee and reverses his order (2 *Collier on Bankruptcy,* 14th Ed., p. 973, Fn 23, Sec. 25.30), this court has expressed a policy of "judicial restraint" in this area.

> *Olympic Finance Co. v. Thyret,* 337 F. 2d 62, 9 Cir. 1964.

On the other hand, if, as here, the case turns, *not* on the District Court's rejection of the Referee's findings of fact based on conflicting evidence or testimonial credibility, but upon the referee's *conclusion* from the facts found, the district judge is free to find on material issues the Referee ignored, find an "abuse of discretion", and reach a different conclusion than the referee did.

> *Costello v. Fazio,* 256 F. 2d 903, 908, 9 Cir. 1958;
>
> *Olympic Finance Co. v. Thyret, supra.*

What the district court rejected here was not the skimpy facts found by the referee [*i.e.* the "substantial equity" finding, C. T. 28], but the referee's *conclusion* that it was proper, notwithstanding the offer of proof as to the individual partners' solvency, etc. [R. T. 12/27/66, p. 28] and Appellee's offer to pay all the unsecured creditors, to grant such an "open-end" injunction.

3. The Scope of a Referee's "Discretion" to Enjoin the Enforcement of Secured Liens Under 11 U.S.C. §714.

It is well-settled that a referee's "discretion" to grant injunctions under 11 *U.S.C.* §714 is contingent upon two things:

1. Such injunction is "necessary to facilitate the primary purpose" of the Chapter XI proceedings (the payment of unsecured creditors); and,
2. The injunction "does not cause substantial injury to the lienor."*

In re Tracy, 194 F. Supp. 293, N.D. Cal. 1961;
Chaffee County Fluorspar Corp. v. Athan, 169 F. 2d 448, 10 Cir., 1948;
In re Holiday Lodge, Inc., 300 F. 2d 516, 7 Cir., 1962.

The Referee here did not make either findings or conclusions as to either one of these jurisdictional conditions precedent to his exercise of discretion. His

*Despite Appellant's argument (Brief, pp. 21-23) premised on the Referee's "substantial equity" finding [C. T. p. 28, lines 18-25], which rests solely on Mr. Herter's opinion as an "owner" [R. T. 12/27/66, pp. 83, 90-91] that there was a huge equity after *four* trust deeds (65% of the value), an 11 *U.S.C.* §714 injunction here plainly caused "substantial injury" to Appellee. Appellee is the 3rd Trust Deed holder and junior to United California Bank and Preissman and May [Ex. 3; R. T. 12/27/66, p. 4; R. T. 1/5/67, pp. 2-3]. At such time as such senior trust deed holders cause a sale thereunder, Appellee must be ready to bid in cash, the amounts due thereon, including the interest and costs accrued, or have its security wiped out. *Sohn v. California Bank,* 124 Cal. App. 2d 757, 269 P. 2d 223; *Streiff v. Darlington,* 9 Cal. 2d 42, 68 P. 2d 728. While a secured creditor can be compelled to forego interest, *pendente lite,* without detriment (*Vanston v. Green,* 329 U.S. 156), a junior lienholder who must stand ready to *advance* additional funds in the future to protect its security is substantially injured by a stay.

naked conclusion that an injunction should issue was hence clearly subject to review and reversal free from any presumption of correctness.

In ignoring and rejecting Appellee's offer to do equity by paying all the unsecured creditors in full, forthwith [R. T. 12/27/66, pp. 6-17], the Referee plainly "violated the rules of equity."

Maas v. United States, supra.

And in so rejecting Appellee's offer to pay the unsecured creditors in full, forthwith, in favor of the Debtor's proposed six year plan of arrangement, the Referee was guilty of an "improvident grant" of an injuncion, since under the undisputed facts, *no* possible plan of arrangement could be fair, equitable and feasible when compared, with the unsecured creditors' opportunity to be paid in full, forthwith.

Case v. Los Angeles Lumber Co., 308 U.S. 101, 114;

Technical Color & Chem. Works v. Two Guys From Massapequa, 327 F. 2d 737, 741.

Furthermore, on the undisputed facts of this record, there is no substantial evidence (indeed no evidence at all) that the injunction was "necessary to facilitate the primary purpose" of the Chapter XI proceeding. A finding that the injunction was necessary to secure the orderly payment of unsecured creditors would have been "clearly erroneous".

Finally, under the plainest principles of equity, the alleged co-partners should be estopped to claim title to

the land to restrain Appellee's lien by a Chapter XI proceeding in any event, because they allowed Heiter to appear as the true owner and obtain money on the strength of his record title.

Butler v. Woodburn, 19 Cal. 2d 420, 425, 122 P. 2d 17, 20;

Andrade v. Casteel, 81 Cal. App. 2d 729, 185 P. 2d 51, 52;

Mills v. Rossiter, 156 Cal. 167, 103 Pac. 896-897;

Kierulff v. Metropolitan S. Co., 315 F. 2d 839, 842-843, 9 Cir., 1963;

Jeggle v. Mansur, 17 F. 2d 729, 9 Cir., 1927, cert. den. 274 U.S. 758.

Appellee would not have dealt with Barnes, or made the loan to a partnership where Barnes was a partner [R. T. 12/27/66, pp. 70-71]. Having induced Appellee to enter the transaction by allowing Herter to hold record title and represent *his* ownership while concealing Barnes' interest [Ex. 4, ¶ 1a; 6], the partners are estopped to assert that the land was and is a partnership asset to Appellee's detriment.

Farmers Bros. Co. v. Huddle Enterprises, Inc., 366 F. 2d 143, 148, 9 Cir., 1966.

4. The Scope of Review by the Court of Appeals.

When the district court, without taking any additional evidence, rejects the referee's findings, makes contrary findings of his own, and reverses the referee's determination, the court of appeals tests the referee's findings under the "clearly erroneous" rule.

Lines v. Falstaff Brewing Co., 233 F. 2d 927, 9 Cir. 1956.

However, the "clearly erroneous" rule does *not* apply to the referee's conclusions of law, *i.e.* "an erroneous interpretation of the standard to be applied".

> *Utley v. United States,* 304 F. 2d 746, 9 Cir., 1962;
>
> *Lama Company v. Union Bank,* 315 F. 2d 750, 9 Cir., 1950;
>
> *Solomon v. Northwestern State Bank,* 327 F. 2d 720, 724-725, 8 Cir., 1964;
>
> *In re Lightner,* 184 F. Supp. 825, S.D. Cal.

Here, it was the Referee's errors of law and failure to find on material issues which led the District Court to reverse—not the referee's findings.

Where, as here, the referee's "findings" are either silent on the pivotal issues or are so sparse that the district court cannot determine what standard the referee applied in awarding the injunction (*Commissioner v. Duberstein,* 363 U.S. 278, 292) the district court has not only the power but the duty under General Order No. 47, to "modify" the referee's report as appropriate.

> *Carter v. Kubler,* 320 U.S. 243, 247-249.

In such a case, it is the district court's findings—which are not contrary to the referee's findings—which are reviewed by the court of appeals.

The question of whether an 11 *U.S.C.* §714 injunction should issue in a particular case rests in the referee's "discretion" *provided* he has applied the correct legal standard in reaching his conclusion.

But where, as here, the District Court has determined that the Referee did *not* apply the correct legal standard, and makes new findings, applying the correct standard,

> ". . . Manifestly when a district judge so proceeds it is *his* findings of fact and conclusions as to which the 'clearly erroneous' standard of Rule 52, F.R. Civ. P. should be applied." (Italics added).
>
> *Employers Mutual Casualty Co. v. Hinshaw,* 309 F. 2d 806, 809, Fn. 2, 8 Cir., 1962.

Here, the Referee's finding of an "equity" [C. T. p. 28, lines 18-25] was not overturned. What the District Court did was to make an independent review of the record, decide that the individual partners' solvency *was* material, decide that Appellee's offer to pay [R. T. 11/27/66, pp. 6-17] repeated in the District Court [R. T. 5/1/67, pp. 19-23] foreclosed a lengthy "plan of arrangement", and make appropriate findings and conclusions. The Referee's "equity" finding then became moot. An "equity" *qua* equity is not enough for an 11 *U.S.C.* §714 injunction. There must be an insolvent debtor *and* unsecured creditors, *and* the plan (which the lien enforcement would embarrass) must be "fair and equitable".

5. Appellant's Misconception of a Referee's "Discretion."

Appellant's Brief (pp. 13-14) evidences a common misapprehension—that the precise meaning of "discretion" can be expressed as a universal verbal formula.

Quoting liberally from *Lines v. Falstaff Brewing Co.,* 233 F. 2d 927, 932, 9 Cir., appellant seems to suggest that a trial court (or a referee) can never be said to have "abused" his discretion unless "no reasonable man" would take the view adopted, and that such "reasonable man" rule adds additional precision to a determination of whether discretion has been abused.

On the contrary, "discretion" is a chameleon-like concept in the law which takes on the coloration of its surroundings. The true rule is that there is no magic verbal touchstone. As the Supreme Court has put it in *Langnes v. Green,* 282 U.S. 531, 541:

> "The term 'discretion' denotes the absence of a hard and fast rule."

Here, if regard is given to what is right and equitable "under the circumstances and the law" (*Langnes v. Green, supra*) governing the summary jurisdiction of the Bankruptcy Court to enjoin secured creditors, no "reasonable man" (*i.e.* no reasonable, experienced judge) would have issued the order the Referee did. But the determination of whether the Referee "abused his discretion" is clouded, not aided by the "reasonable man" gloss.

Here, as in the *Langnes* case, the problem presented by the Appellee's offer to pay all unsecured creditors in full was quite simple.

Upon the face of the record, appellee's offered payment would afford the Debtor all the relief it was entitled to in a Chapter XI proceeding—the payment of unsecured creditors in an orderly and expeditious manner.

The difference in the effect of adopting one or the other of the two alternatives presented to the Referee and the District Court was obvious. To retain the Chapter XI proceeding and proceed with the proposed plan while enjoining the secured creditors' normal enforcement of their liens, would be to permit the Debtor to "rehabilitate" itself over the six year plan, but to rob the unsecured creditors of the opportunity to have

their claims paid at once in full, and to freeze the secured creditors' assets; to allow Appellee to pay the unsecured claims and expenses of administration, dismiss the proceeding and remit the parties to their rights and remedies under California law would be to preserve the rights of both parties and accomplish the primary purpose of a Chapter XI proceeding.

The mere statement of these diverse results is, as in the *Langnes* case, "sufficient to demonstrate the justice of the latter course."

B. The District Court Correctly Held That the Solvency and Ability of Individual Partners to Pay Partnership Debts as They Mature Is Material to the Solvency and Ability of the Partnership to Pay Its Debts (11 U.S.C. §723), and That in Ruling to the Contrary and Awarding an Injunction, the Referee "Abused His Discretion."

The Chapter XI Petition filed on December 20, 1966, was signed by each of the four alleged partners, but it was filed *solely* on behalf of "Casa Dorinda Estates". The Petition alleged that such alleged partnership was "unable to pay its debts as they mature" and proposed an "arrangement" [Debtor's Petition, p. 1, lines 28-30], under which an alleged $7,177.44 in partnership unsecured debts [Debtor's Petition, Schedule A-3] would be paid over a six (6) year period after confirmation [Proposed Plan of Arrangement]. The solvency of the individual alleged partners and their individual ability to pay debts as they matured was not referred to in the Petition.

At the Order to Show Cause hearing, the alleged Debtor offered no evidence as to either the partner-

ship's inability to pay its debts or of the individual inability of the partners to pay such debts.

Charles B. Herter, Jr., one of the alleged partners, testified that he had individual assets of his own, including an airplane which he used like ordinary men use an automobile [R. T. 12/27/66, p. 47, lines 13-21]. The Referee sustained an objection of immateriality to further inquiry into the assets of the individual partners [R. T. 12/27/66, p. 27, lines 4-11]. Appellee offered to prove that each of the individual alleged copartners had the ability to pay the alleged unsecured debts [R. T. 12/27/66, p. 28, lines 13-19]. The Referee rejected such offer, ruling that the individual solvency of such partners was "immaterial" to the issue of the Debtor *partnership's* solvency [R. T. 12/27/66, p. 28, lines 20-21], and the question whether an 11 *U.S.C.* §714 injunction was proper.

The law is clear that under an allegation of *partnership* insolvency, the insolvency of the *individual* partners must be proven.

11 *U.S.C.* §§702, 706, 707, 711, 723;

Mason v. Mitchell, 135 F. 2d 599, 9 Cir., 1943;

Kaufman-Brown Potato Co. v. Long, 182 F. 2d 594, 601-602, 9 Cir., 1950;

Charles Arnold & Associates v. England, 301 F. 2d 572, 574, 9 Cir., 1962;

In re Pauline's Fashion Salon, 121 F. Supp. 845, 852, S.D. Cal. 1954;

Young v. Riddell, 283 F. 2d 909, 910, 9 Cir., 1960;
(Each partner is "personally liable for the debts and liabilities of the partnership");

9 *Am. Jur. 2d* 179-180, Bankruptcy §169.

The reason for this is that even when the partnership alone is the Debtor, the Bankruptcy Act required that each individual partner "surrender" such of "his individual property" as is required to pay the partnership debts.

> 11 *U.S.C.* §23;
>
> *Liberty National Bank v. Beat,* 276 U.S. 215, 224, 72 L. ed. 536, 540.

And if, after such surrender and payment, there are no unsecured debts, the issuance of an 11 *U.S.C.* §714 injunction against secured lien enforcement would be improper, because no "arrangement" is necessary.

On oral argument as to whether the preliminary injunction should issue, Appellee cited *Mason v. Mitchell,* 135 F. 2d 599, 9 Cir., 1943, and argued that the threshold prerequisite (11 *U.S.C.* §723) to the exercise of summary discretion (11 *U.S.C.* §714) had not been proven [R. T. 1/5/67, p. 38, line 21, to p. 40, line 23].

The Referee held that individual partners could lawfully *insulate* their individual assets from their partnership's debts; that an allegation of the *partnership's* insolvency or inability to pay in the Debtor's Petition would support a summary stay of a secured lien regardless of the individual partners' solvency and ability to pay such debts [R. T. 1/5/67, p. 40, line 24, to p. 43, line 17].

The Referee clearly erred in rejecting the offer of proof and in his construction of the statutory prerequisites to summary discretion to issue an injunc-

tion. Despite the fact that the 11 *U.S.C.* §723 solvency issue was presented [C. T. 7-8], the Referee made no findings on such issue.

The District Court correctly found and concluded that the Referee had erred [F. of F. 2, 3, C. of L. II, III, IV, C. T. 52, 53], and found and concluded that the Referee had "abused his discretion" in granting the preliminary injunction [F. of F. 8, C. of L. VII, C. T. 54-55].

The Referee's failure to find upon this key issue of insolvency would alone have justified the District Court in finding an abuse of discretion awarding the injunction.

The award of an injunction is never a matter of right, but is a matter of sound judicial discretion.

> *Yakus v. United States,* 321 U.S. 414, 420, 88 L. ed. 834, 857.

Thus, it is "of the highest importance" that adequate, comprehensive findings be made.

> *Mayo v. Lakeland Highlands Can Co.,* 309 U.S. 310, 316, 84 L. ed. 774, 779.

The Referee's failure to find justified the District Court in making its own findings and conclusions on this crucial issue, and in finding and concluding that the Referee "abused his discretion" in granting the injunction.

C. The District Court Correctly Remanded the Matter to the Referee to Allow Appellee to Pay the Unsecured Debts and Reasonable Costs of Administration.

At the hearing before the District Court, Appellee renewed its offer to pay all the unsecured debts and the reasonable costs of administration [R. T. 5/1/67, pp. 19-24].

The Court then ruled that the Referee lacked the power to issue the injunction in the face of Appellee's offer [R. T. 5/1/67, pp. 23-24].

The District Court made appropriate findings and conclusions and an Order, reversing the Referee and remanding the matter [F. of F. 4, 5, 6, 8; C. of L. V, VI, VII; Order; C. T. 53-55, 56, lines 17-26]. *General Order No. 47,* General Orders in Bankruptcy.

Appellant now challenges such Order (Brief, pp. 18, 21-23). The basis of such challenge is the assertion, unsupported by authority, that the partnership Debtor is "entitled to receive the rehabilitation benefits of a Chapter XI proceedings" (Brief, p. 21), together with the argument that there is a substantial equity in the property and that Appellee hence will assertedly suffer no substantial injury by the continuance of the injunction (Brief, pp. 21-23).

There is grave doubt whether there *is* "substantial evidence" in support of the Referee's finding of an equity. But even if there be an equity, Appellant's remedies lie under California law*—not Chapter XI. A secret partnership short of partnership cash, but whose members are solvent, cannot in equity forestall

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*If there be a $665,000 equity, as Appellant asserts (Brief p. 22), there will be plenty of bidders at the trustee's sale.

secured creditors who dealt with a solvent individual partner, by claiming that the secured property is really the partnership's. The equitable doctrines of "clean hands" and "he who seeks equity must do equity" forbid this. And when the secured creditor offers, in addition, to pay the unsecured partnership debts, all justification for a stay disappears.

Appellee's offer to pay all of the unsecured creditors forthwith, in full [R. T. 12/27/66, pp. 6-17], and its tender of a cashier's check with which to do so, completely undercut the Debtor's position.

Without unpaid unsecured debts, there would be nothing to "arrange" and no legal or equitable basis for a Chapter XI arrangement proceedings (11 *U.S.C.* §§702, 707, 711, 723).

The Referee apparently adopted the Appellant's argument (which Appellant now attempts to support) that the "rehabilitation" of a Debtor without unsecured debts is a proper and lawful basis for the restraint of secured creditors under 11 *U.S.*C. §714.

Appellant now asserts that the "rehabilitation" of a Debtor is "a primary purpose" of Chapter XI proceeding (Brief, pp. 16-18).

Appellant misreads the authorities it cites for such asserted proposition.

To be sure, the "rehabilitation" of debtors is a broad purpose and goal of the entire Bankruptcy Act.

Chapter XI proceedings are a method of adjusting unsecured debts and the debtor's ultimate financial rehabilitation resulting therefrom.

> *S.E.C. v. American Trailer Rentals,* 379 U.S. 594, 605-607.

But although the "goal" of a Chapter XI proceeding is the "rehabilitation" to be achieved by the arrangement of unsecured debts (*Nicholas v. United States,* 384 U.S. 678, 687), such "goal" does not expand the Bankruptcy Court's summary power over secured creditors, which is dependent upon the existence of unsecured debts. Nor does such "goal" authorize the Bankruptcy Court to alter the rights of secured creditors (*S.E.C. v. United States Realty Co.,* 310 U.S. 434), in order to "rehabilitate" the Debtor as to secured debts.

There are few land-poor speculators who would not welcome a moratorium on their secured debts and the chance to sell the land slowly, without regard to the cost of money. Doubtless a semantic argument can be made that such a moratorium would "rehabilitate" a speculator who was short of ready cash with which to pay the installments on his secured debts. This, however, is *not* the "rehabilitation" contemplated by Chapter XI, nor would it be constitutional.

Conclusion.

It would be hard to imagine a clearer case of commercial dishonesty than the scheme laid bare by the record in this case.

A group of land speculators secured funds by putting forward their most affluent and personable member as the record owner and "front man", and secured such loans by trust deeds on the land. Upon default in the

payments on the trust deeds and taxes, and threatened foreclosure, the secret partnership surfaced, filed a Chapter XI Petition in the name of the partnership, and sought an injunction restraining the lender's enforcement of their secured liens during the pendency of a six (6) year "Plan" of arrangment to pay $7,177.14 in alleged partnership unsecured debts.

The Referee saw nothing reprehensible in either the scheme or the speculators' fraud and mendacity [R. T. 1/5/67, p. 62, lines 20-26] and granted the injunction.

The Appellant now challenges the District Court's Order of reversal, arguing that it was error for the Court to find that the Referee "abused his discretion", and to dissolve the injunction as to Appellee (the third trust deed holder), and asserting that the partnership should be allowed to "rehabilitate" itself.

The appeal, though frivolous, has accomplished further delay. The title is still clouded by the Chapter XI proceedings. No payments have been made on taxes or the trust deeds in the 12 months the matter has been pending.

The alleged Debtor's *real* problem is not the $7,177.14 in unsecured debts, but the "partners' " hope to sell the land for more than the trust deed debts and taxes. Such persons' remedy was a Chapter XII proceedings —not Chapter XI. Here, as in *Securities & Exch. Commission v. United States R. & Imp. Co.,* 310 U.S. 434, where the proper remedy was Chapter X (rather than Chapter XI) "it was plainly the duty of the district

court" to remand with a direction that the proceedings be dismissed upon Appellee's payment of the unsecured creditors and the reasonable expenses of administration.

The Order of the District Court was clearly correct and should be affirmed.

December 19, 1967

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Norman Elliott